NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **June 2011** **LETTER No.: 11-CU-08**

TO: **Federally Insured Credit Unions**

SUBJ: **Voluntary Prepayment of Assessments Program**

ENCL:
(1) Terms and Conditions of the Program
(2) Program Agreement Instructions
(3) Authorization Agreement for Electronic Funds Transfer Payments
(4) Frequently Asked Questions and Answers

Dear Board of Directors:

Credit unions requested NCUA provide a program using prepayments to level out the assessments arising from the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund) in the next few years. Based on those requests, NCUA developed a potential program design and requested comments from credit unions on the various aspects of the program outlined. The comments received indicated that many responding credit unions were in favor of having the ability to voluntarily prepay assessments. The comment letters also recommended some changes to the original proposed program.

There were several guiding principles that NCUA adhered to in establishing the ability for credit unions to make prepayments:

1. The prepayment program would not result in limiting the NCUA's ability to vary as warranted the annual level of regular assessments. It is NCUA's intent to set the annual assessments to be counter-cyclical with respect to credit union performance, varying them from year to year based on the credit union system's capacity to absorb the costs, and taking into consideration current conditions and future risks.
2. Treasury borrowings would be repaid at a responsible rate to ensure adequate borrowing capacity.
3. The amount of prepayment for any individual credit union would not have a material impact on the balance sheet or income statement of that credit union.
4. The aggregate amount of prepayments would be sufficient to create a meaningful impact on the amount of near term (i.e., 2011) Stabilization Fund assessments.

Background

When the Corporate System Resolution program was implemented in September 2010, communication materials made it clear that large cash outlays in 2011 and 2012 associated with the funding of the bridge corporates, the Temporary Corporate Credit Union Liquidity Guarantee Program, and the Temporary Corporate Credit Union Share Guarantee Program were expected. The November 2010 announcement of the projected 20 to 35 basis points combined 2011 Stabilization Fund assessment and NCUSIF premium included these cash needs as significant factors in the projection.

Current Stabilization Fund cash flow projections indicate a total of $8.44 billion in uses of funds will need to be financed through borrowed funds, assessments, or other means for the period from January 2011 through October 2012. Drawing $5.5 billion from NCUA's $6 billion borrowing authority will provide the majority of the funding.[1] This leaves approximately $2.94 billion in additional cash needs that must be funded through actual assessments and the prepayment of assessments from now through October of 2012.

Raising $2.94 billion would equate to assessments of about 38 basis points of insured shares in total for 2011 and 2012 combined. For example, a 2011 assessment of 25 basis points and a 2012 assessment of 13 basis points, totaling 38 basis points combined, would generate approximately the needed $2.94 billion. This level of assessments is within the range used for NCUA's original modeling of the impact on credit union earnings, net worth, and liquidity of the timing and amount of corporate resolution costs. Voluntary prepayment of assessments would reduce 2011 Stabilization Fund assessments.

Voluntary Prepayment of Assessments Program

The details of the Program are contained in the *Program Terms and Conditions* (Enclosure 1) attached to this letter. The key elements of the Program are:

- Participation is purely voluntary and nearly all federally insured credit unions are eligible.
  - The minimum individual credit union commitment amount is the greater of $1,000 or 0.05 percent of insured shares as of March 31, 2011.
- The maximum individual credit union participation amount is 0.48 percent of insured shares as of March 31, 2011.
- The size of the Program is $500 million. If less than $500 million is committed, NCUA will not implement the Program. If more than $500 million in commitments are received they will be accepted on a *pro rata* basis to meet the $500 million target.
- Liquidity would be provided to the Stabilization Fund in the form of a prepayment of future Stabilization Fund assessments. Prepayments would be placed in a prepaid assessment account that will be drawn against starting in 2013.

[1] As the NCUA borrowing authority is shared between the National Credit Union Share Insurance Fund (NCUSIF) and the Stabilization fund, NCUA needs to maintain an initial margin against the limit for contingencies of at least $500 million to be able to respond to contingencies.

As comment letters requested, all voluntarily prepaid assessments would reduce the amount of 2011 assessments on a dollar for dollar basis. The $500 million target amount is necessary to make the program administratively effective with relatively wide participation and provide a meaningful reduction in the regular 2011 assessment. The $500 million program goal equates to 6.4 basis points of system-wide insured shares, and would reduce the 2011 regular assessment dollar-for-dollar from 24.9 basis points to 18.5 basis points. The Program goal was increased from $300 million in the original proposal based on credit union comment letters.

NCUA arrived at the $500 million target level for a dollar-for-dollar 2011 regular assessment reduction based on the following key considerations:

- The timing of liquidity needs of the Stabilization Fund over the life of the Program (i.e., during the period after 2012 where any regular assessments would draw down prepaids and not contribute additional funding);
- The overall long-term costs of Treasury borrowings and associated interest rate risk;
- NCUA's borrowing authority and the potential for future stresses on performance of the NCUSIF and credit union earnings and liquidity; and
- Impact of both Stabilization Fund assessments and potential NCUSIF premiums on individual credit unions and the industry both in the short and long term.

The specific Program goal of $500 million preserves NCUA's flexibility in (a) managing the regular annual assessments over the life of the Stabilization Fund (especially in the next 4 to 5 years), which are an expense to credit unions, in as counter-cyclical a manner as possible, and (b) managing the cash needs and contingency funding available to the Stabilization Fund.

As noted, the prepayment program provides flexibility in the timing of assessments over the period 2011 through 2014, **but not the aggregate amount of assessments that need to be collected.** Therefore reductions in assessments in 2011 must be offset with increases in 2013 and 2014 if NCUA achieves target levels of available contingency funding through the Treasury borrowing authority. A direct implication is that while a larger prepayment program (e.g. $1 billion) would have allowed larger reductions to 2011 assessments, it would also have required substantially larger increases to the projected level of credit unions' 2013 and 2014 assessments.

Prior to setting the Stabilization Fund assessment for 2011, NCUA will need to know with certainty the amount of funding committed through the Program. Thus, credit unions intending to voluntarily prepay assessments are required to inform NCUA of their desire to participate by July 29, 2011. Details concerning the commitment collection process are included in the *Program Agreement* (Enclosure 2) attached to this letter.

The industry has substantial liquidity. As of March 31, 2011, federally insured credit unions held more than $80 billion in liquid balances. NCUA believes most of the prepaid funds would be drawn from available cash and short-term investments, which should not significantly affect credit union net income or lending activities. The maximum individual credit union limit of 48 basis points is low enough to be considered immaterial from an impact on liquidity and earnings. Therefore, a credit union's participation (or lack thereof) will not be a factor (either positive or negative) in any NCUA regulatory or insurance matters. However, credit unions contemplating participating in the Program need to evaluate the associated lost opportunity cost and impact on liquidity of not having access to any funds provided.

While NCUA believes there should be no adverse accounting implications for credit unions participating in such a program, as part of its due diligence each credit union would need to research the appropriate accounting treatment prior to any commitment. As a credit union considers the appropriate financial reporting of its participation in the Program, it should review relevant generally accepted accounting principles (GAAP) and consult its independent accountant.

The NCUA Program is structured differently than the FDIC's prepaid assessment program so the related accounting may differ. GAAP guidance on loan accounting, the interest method, imputing interest, contributions, and applying GAAP to immaterial items may be considerations in reporting. In no case would amounts of imputed interest, if any, be added to the advance balance as available to absorb assessments. Notwithstanding outstanding advance balances, each participating credit union would record assessment expenses annually as they are made by the NCUA Board.[2]

Prepayment of assessments does not change the ultimate cost of the corporate resolution plan. The funding provided through prepayments only affects the timing of expensing Stabilization Fund assessments, and the most recent estimate of the remaining assessments of $7 billion to $9.2 billion has not changed at this time.

NCUA will be holding a webinar to answer questions on Monday, July 11, 2011, at 2 P.M. EDT. You may find additional information on the Program by clicking on the following link: http://www.ncua.gov/news/VoluntaryPrePaymentAssessmentProgram.aspx. Questions may be e-mailed to assessments@ncua.gov.

Sincerely,

/s/

Debbie Matz
Chairman

Enclosures

[2] To the extent that the National Credit Union Administration assesses premiums to cover prior operating losses of the insurance fund or to increase the fund balance to normal operating levels, credit unions shall expense those premiums when assessed. [FASB ASC 942]